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No. 91-1135

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

NEWARK MORNING LEDGER CO.,
as successor to The Herald Company,
Petitioner,
v.
UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF AMICUS CURIAE OF NEWSPAPER ASSOCIATION OF AMERICA (FORMERLY AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION) IN SUPPORT OF PETITIONER

GEORGE L. MIDDLETON, JR.
Counsel of Record
CHRISTIAN M. MCBURNEY
CORRINE M. YU
NIXON, HARGRAVE, DEVANS & DOYLE
One Thomas Circle, N.W.
Suite 800
Washington, D.C. 20005
(202) 457-5300
Counsel for Newspaper Association of America

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF INTEREST	1
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. THE COST OF WASTING INTANGIBLE ASSETS, LIKE THE COST OF WASTING TANGIBLE ASSETS, MUST BE RECOVERED OVER THE USEFUL LIVES OF THE ASSETS	4
A. Introduction	4
B. The Statutory and Regulatory Scheme	5
C. Interpretation of Treas. Reg. § 1.167(a)-3 in Light of Statutory and Regulatory Scheme	9
D. The Errors of the Third Circuit's Approach	11
E. Summary	15
II. THE INITIAL PAID SUBSCRIBERS ARE ANALOGOUS TO PATENTS AND SHOULD BE TAXED SIMILARLY	17
III. NEWSPAPER SUBSCRIBERS CANNOT BE ANALYZED SIMPLY AS CUSTOMERS	20
CONCLUSION	23

TABLE OF AUTHORITIES

Cases — Page

Associated Patentees, Inc. v. Commissioner, 4 T.C. 979 (1945), *acq.*, 1959-2 C.B. 3 18
Bank of New York v. United States, 526 F.2d 1012 (3d Cir. 1975) 10
Bhada v. Commissioner, 89 T.C. 959 (1987), *aff'd*, 892 F.2d 39 (6th Cir. 1989) 15-16
Clifford v. Helvering, 105 F.2d 586 (8th Cir. 1939), *rev'd on other grounds*, 309 U.S. 331 (1940) 17
Collums v. United States, 480 F. Supp. 864 (D. Wyo. 1979) 16
Colorado National Bankshares, Inc. v. Commissioner, 60 T.C.M. 771 (1990) 11, 16
Commissioner v. Idaho Power Co., 418 U.S. 1 (1974) 6
Dixon v. United States, 381 U.S. 68 (1965) 9
Donrey, Inc. v. United States, 809 F.2d 534 (8th Cir. 1987) 21
Espinoza v. Farah Mfg. Co., 414 U.S. 86 (1973) 16
Estate of Boeshore v. Commissioner, 78 T.C. 523 (1982) 15
Federal Maritime Comm. v. Seatrain Line, 411 U.S. 726 (1973) 15
INDOPCO, Inc. v. Commissioner, 112 S. Ct. 1039 (1992) 6
Iselin v. United States, 270 U.S. 245 (1926) 16
Koshland v. Helvering, 298 U.S. 441 (1936) 10
Massey Motors v. United States, 364 U.S. 92 (1960) 6, 12
McCoog v. Hegstrom, 690 F.2d 1280 (9th Cir. 1982) 10
Newton Insert Co. v. Commissioner, 61 T.C. 570 (1974) 20
Niagara Falls Brewing Co. v. Commissioner, 38 F.2d 217 (2d Cir. 1929) 15
Northern Natural Gas Co. v. O'Malley, 277 F.2d 128 (8th Cir. 1960) 7, 8, 9-10, 12, 15
Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969) 16

TABLE OF AUTHORITIES—Continued

Page

Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446 (Ct. Cl. 1976) 9, 11, 16
Southland Royalty Co. v. Federal Energy Admin., 512 F. Supp. 436 (N.D. Tex. 1980) 15
Trustees of Indiana University v. United States, 618 F.2d 736 (Ct. Cl. 1980) 10
United Fire Insurance Co. v. Commissioner, 768 F.2d 164 (7th Cir. 1985) 16
United States v. Calamaro, 354 U.S. 351 (1957) 16

Statutes

35 U.S.C. §§ 154, 173 18

Internal Revenue Code of 1986

Section 56(b)(2) 19
Section 59(e) 19
Section 167(a) ..... *passim*
Section 168 13
Section 173 ..... 14, 19
Section 174(a) 19
Section 174(b) 19
Section 179 14
Sections 1221, 1231 and 1235 20

Regulations

Treas. Reg. § 1.167(a)-1(a) 7
Treas. Reg. § 1.167(a)-1(b) 7, 8, 18
Treas. Reg. § 1.167(a)-3 ..... *passim*
Treas. Reg. § 1.167(a)-6(a) 18, 20
Treas. Reg. § 1.173-1(a)(1) 20
Treas. Reg. § 1.173-1(c)(1) 19
Treas. Reg. § 1.174-2(a)(1) 19

Miscellaneous

Rev. Rul. 74-103, 1974-1 C.B. 62 20
Rev. Rul. 67-136, 1967-1 C.B. 58 18
H.R. Rep. No. 1337, 83d Cong., 2d Sess. (-954) 6
H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. (1987) 11
1 *Mertens Law of Federal Income Taxation* (1992) 17

TABLE OF AUTHORITIES—Continued

	Page
Petry, M., *Taxation of Intellectual Property* (1991)	18
Cross, J., 209-4th Tax Management Portfolios, *Purchase Price Allocation and Amortization of Intangibles* (1991)	18

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STATEMENT OF INTEREST

Newspaper Association of America ("NAA") is a non-profit trade association representing approximately 1,700 member newspapers.[1] Its membership includes newspapers that are responsible for about 90 percent of the total daily and Sunday newspaper circulation, and a substantial portion of the non-daily newspaper circulation, in the United States.

[1] Prior to June 1, 1992, NAA was known as American Newspaper Publishers Association. Its name changed on June 1, 1992 when several other newspaper groups merged with it to form NAA.

NAA submits this brief *amicus curiae* in support of Petiitoner.[2] Many NAA members, including Petitioner itself, have acquired operating newspapers in the past and will continue to acquire operating newspapers in the future. In most newspaper acquisitions, a relatively small portion—perhaps 20 percent to 30 percent—of the purchase price can be traced to the tangible assets. For example, the acquisitions of Petitioner that are the subject of this lawsuit involve tangible assets with a value of only approximately 23 percent of the purchase price of the newspapers. See summary of values, Pet. App. at 36a.

Believing that few, if any, assets used in a business have a permanent value, many NAA members that acquired newspapers analyzed what portion of the amount that they paid in excess of the value of the tangible assets could be expected to decline over time. They knew in particular that the paying subscribers that existed on the date of purchase (the "initial paid subscribers") would be of use in the business for only a limited period of time. They also knew that the initial paid subscribers were valuable assets primarily because they served to attract advertisers. Accordingly, NAA members concluded that the portion of the purchase price attributable to the initial paid subscribers was properly depreciated over the useful lives of those subscribers.

Economic consulting and valuation experts engaged by NAA members generally confirmed the business conclusions described above. The experts advised NAA members that the useful lives of the initial paid subscribers could be determined with reasonable accuracy and that a value could be assigned to those subscribers. Accordingly, many NAA members claimed depreciation deductions on their federal income tax returns.

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[2] Written consents of both parties have been filed with the Clerk of the Court as required by Rule 37 of this Court's rules.

Many NAA members now find themselves in the same position as Petitioner in this case: they have depreciated the basis of the initial paid subscribers, and the Internal Revenue Service has disallowed the claimed deductions. Those members therefore have a strong interest in the outcome of this case.

SUMMARY OF ARGUMENT

By virtue of (i) the district court's unchallenged finding that the initial paid subscribers had limited useful lives which could be estimated with reasonable accuracy, and (ii) the clear mandate of long-standing depreciation rules that wasting assets with limited useful lives are depreciable, the initial paid subscribers should be found to be depreciable. In deciding that the initial paid subscribers were not depreciable, the Court of Appeals for the Third Circuit virtually ignored these points and instead relied upon various judicial definitions of "goodwill". It did not attempt to interpret the applicable Treasury regulation according to the regulation's own words and in the context of the facts of this particular case. It thus approached the issue as an empty semantic exercise, rather than one of regulatory interpretation.

The result reached by the Third Circuit is unsound for three distinct reasons:

First, the Internal Revenue Code and its implementing regulations require that wasting intangible assets be depreciated in order to clearly reflect income. Depreciation deductions for the initial paid subscribers are no different than depreciation deductions for purchased tangible assets.

Second, the Third Circuit's approach results in similar intangible assets—a patent and the initial paid subscribers—being treated differently, even though their tax characteristics are otherwise identical.

Finally, in undertaking its analysis, the Third Circuit viewed newspaper subscribers merely as customers. However, newspaper subscribers are not only customers, they are an asset used by a newspaper to reach its more important customers, which are its advertisers. Accordingly, to identify newspaper subscribers with customers, and customers with "goodwill", misses the fundamental nature of newspaper subscribers.

ARGUMENT

I. THE COST OF WASTING INTANGIBLE ASSETS, LIKE THE COST OF WASTING TANGIBLE ASSETS, MUST BE RECOVERED OVER THE USEFUL LIVES OF THE ASSETS.

A. Introduction.

There is no dispute in this case that Petitioner's initial paid subscribers have limited useful lives that can be estimated with reasonable accuracy. Petitioner and the government entered into a stipulation setting forth the useful lives of the initial paid subscribers for each newspaper involved. Pet. App. at 32a. The district court unequivocably stated that Petitioner "has clearly established that the paying subscribers . . . of the acquired newspapers had limited useful lives, the duration of which can be and has been estimated with reasonable accuracy." *Id.* The Third Circuit admitted that the government never challenged the expert testimony regarding useful lives and that the government had entered into the stipulation establishing the useful lives. Pet. App. at 6a.

Given these uncontroverted facts and the clear mandate of the depreciation rules that wasting assets with limited useful lives are depreciable, it should follow that the initial paid subscribers are, in fact, depreciable. Yet the Third Circuit held to the contrary.

In deciding this case, the Third Circuit stated that it was applying Treas. Reg. § 1.167(a)-3, which provides in part

> If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to good will.

Despite the first sentence quoted above from the regulation and the uncontroverted fact that the initial paid subscribers had useful lives which could be estimated with reasonable accuracy, the Third Circuit held that

> for tax purposes, there are some intangible assets which, notwithstanding that they have wasting lives that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and nondepreciable. [Pet. App. at 28a-29a.]

Although the Third Circuit purports to ground its holding in the case law, in fact no prior court had ever made this bald assertion. It conflicts with the long-standing mandate and purpose of the statute authorizing depreciation deductions for wasting assets with limited useful lives. It also conflicts with the government's own implementing regulations.

B. The Statutory and Regulatory Scheme.

The curent statutory provision that allows the recovery over time of the cost of wasting assets is found in section 167(a) of the Internal Revenue Code of 1986 (the "Code").[3] It provides as follows:

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[3] All statutory references in this brief are to the Code unless otherwise specified.

> (a) GENERAL RULE.—There shall be allowed as a depreceiation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, or
>
> (2) of property held for the production of income.

In discussing the purpose of this provision when it was enacted as part of the Internal Revenue Code of 1954, Congress stated that:

> Depreciation allowances are the method by which the capital invested in an asset is recovered tax-free over the years it is used in a business. The annual deduction is computed by spreading the cost of the property over its estimated useful life.

H.R. Rep. No. 1337, 83d Cong., 2d Sess. 22 (1954).

The purpose of the statute is to accurately match income with the expenses of generating that income. For example, in *Massey Motors v. United States*, 364 U.S. 92 (1960), this Court stated the following:

> It was the purpose of § 23(1) [the predecessor of section 167(a)] and the regulations to make a meaningful allocation of this cost [of a capital asset] to the tax periods benefited by the use of the asset.

Id. at 96. This Court also stated that

> [i]t is the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expenses) of the asset to the periods to which it contributes.

Id. at 104; *see also INDOPCO, Inc. v. Commissioner*, 112 S. Ct. 1039, 1043 (1992) ("through provisions such as [section 167(a)], the Code endeavors to match expenses with the revenues of the taxable period to which they are properly attributable, thereby resulting in a more accurate calculation of the net income for tax purposes."); *Commissioner v. Idaho Power Co.*, 418 U.S. 1, 10-11 (1974) (collecting cases).

The statute unambiguously mandates that a depreciation deduction "shall" be allowed for wasting assets. In *Northern Natural Gas Co. v. O'Malley*, 277 F.2d 128 (8th Cir. 1960), the Eighth Circuit interpreted a Treasury regulation promulgated under the predecessor to section 167(a) (which is substantially identical to current section 167(a) of the Code). The Eighth Circuit recognized the mandatory aspect of the statute:

> It is our belief that the statute authorizing the deduction is mandatory and not permissive, and requires the Commissioner to grant the deduction to a taxpayer who brings his claim within the provision of the statute.

277 F.2d at 131-32. Additionally, the statutory language does not distinguish between tangible and intangible assets. *See Northern Natural Gas*, 277 F.2d at 139 (Blackmum J. concurring) (predecessor to section 167(a) "does not distinguish between tangible and intangible assets and it says nothing by way of disqualifying an asset for depreciation merely because it is an intangible.").

The statutory mandate in section 167(a) is implemented by Treasury Regulations. Treas. Reg. § 1.167(a)-1(a) provides in part that

> [t]he allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property. . . .

This allows the cost of an asset (less its estimated salvage value) to be recovered over the asset's estimated useful life. Treas. Reg. § 1.167(a)-1(b) defines in some detail the "estimated useful life". It provides in pertinent part that

> [f]or the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the

> asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income.

The basic rule of these regulations is therefore to allow the taxpayer to recover the cost of an asset (less its salvage value) over its useful life.

Treas. Reg. § 1.167(a)-3 mirrors that basic rule in the context of intangible assets by providing that:

> [i]f an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance.

This provision embodies the same basic rule as the regulations allowing the recovery of the cost of wasting tangible assets: the cost of a wasting asset is to be recovered over its useful life.[4]

In summary, both section 167(a) and its implementing regulations provide that the cost of a wasting asset, tangible or intangible, may be depreciated. Furthermore, the purpose of section 167(a) and the regulations issued thereunder is to accurately match income and the expenses of generating the income. The law was summarized by the Eighth Circuit in *Northern Natural Gas*:

> The right-of-way here involved constitutes property. The parties concede that the right-of-way is intangible property and we shall so assume. We observe here, however, that the statute itself makes no distinction between tangible and intangible property.

[4] Treas. Reg. § 1.167(a)-3 simply adds the requirement that the useful life of an intangible asset be estimated "with reasonable accuracy". The district court found that Petitioner had established that the initial paid subscribers had useful lives that had been determined with reasonable accuracy. Pet. App. at 32a. The Third Circuit did not set that finding aside. Thus, the slight difference between the general standard of Treas. Reg. § 1.167(a)-1(b) and the specific standard of Treas. Reg. § 167(a)-3 is immaterial for purposes of this case.

> *If the taxpayer's income producing property is undergoing exhaustion, the statute authorizes a depreciation deduction.*

277 F.2d at 131 (emphasis added).

C. Interpretation of Treas. Reg. § 1.167(a)-3 in Light of Statutory and Regulatory Scheme.

This case centers around the interpretation of Treas. Reg. § 1.167(a)-3. Because initial paid subscribers are intangible assets with limited useful lives which can be estimated with reasonable accuracy, the initial paid subscribers should be depreciable by virtue of the first sentence in Treas. Reg. § 1.167(a)-3. However, Treas. Reg. § 1.167(a)-3 also states that "goodwill" is nondepreciable. The regulation does not define 'goodwill" and the term has no commonly-accepted definition.[5] (This brief will consistently refer to "goodwill" in quotation marks, to emphasize that the term has no commonly-accepted definition.) Therefore, the application of Treas. Reg. § 1.167(a)-3 must be determined by applying established rules of regulatory construction.

Those established rules require that Treas. Reg. § 1.167(a)-3 be interpreted so as to be consistent with, and not to conflict with, the purposes of section 167(a), the statute it implements. *See, e.g., Dixon v. United States*, 381 U.S. 68, 74 (1965) (regulations may not be interpreted in such a manner as to go beyond the author-

[5] For example, "goodwill" has been defined as

- an intangible asset "that has no ascertainable useful life,"
- "the aggregate of all of the intangibles of a business,"
- "the return on all the intangibles of a business,"
- "a rate of return on investment which is above normal returns in the industry," and
- "the expectancy that the old customers will resort to the old place."

See Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446, 450-51 (Ct. Cl. 1976).

ity of the statute they implement); *Bank of New York v. United States*, 526 F.2d 1012, 1018 (3d Cir. 1975) ("Treasury Regulations must be interpreted in the context of the statute they are designed to explicate; 'there is no power to amend [a statute] by regulation.'") (quoting *Koshland v. Helvering*, 298 U.S. 441, 447 (1936)); *Trustees of Indiana University v. United States*, 618 F.2d 736, 739 (Ct. Cl. 1980) ("a regulation must be interpreted so as to harmonize with and further and not to conflict with the objective of the statute it implements").

Additionally, Treas. Reg. § 1.167(a)-3 should be interpretated so as to be consistent with the other provisions of the Treasury's own regulatory scheme under section 167(a). *See Northern Natural Gas*, 277 F.2d at 135 (the court "fully agrees with the view expressed by Judge Blackmun that [the predecessor of Treas. Reg. § 1.167(a)-3] cannot be viewed and interpreted in isolation. The regulation is part of a group of comprehensive regulations dealing with the depreciation deduction and all such regulations should properly be construed together as a whole"); *see also McCoog v. Hegstrom*, 690 F.2d 1280, 1284 (9th Cir. 1982) (deference due an administrative interpretation depends in part on "the purpose and wording of other agency regulations").

The first sentence of Treas. Reg. § 1.167(a)-3 provides the basic rule that an intangible asset, the useful life of which can be estimated with reasonable accuracy, may be depreciated. The regulation gives patents and copyrights as examples. Next, the regulation provides the corollary rule that an intangible asset, the useful life of which is not limited, is not depreciable. The regulation then states that no depreciation deduction is allowable for "goodwill". The regulation says nothing more on the subject.

In view of the basic rule of the statute and the scheme of the section 167(a) regulations, the initial paid subscribers should be treated as falling within the first sentence of Treas. Reg. § 1.167(a)-3 because they are intangible assets with limited useful lives which can be estimated with reasonable accuracy. Correspondingly, the reference to "goodwill" in Treas. Reg. § 1.167(a)-3 should be treated as an *example* of the corollary rule in the regulation that an intangible asset without a reasonably determinable useful life cannot be depreciated. Under this approach, Treas. Reg. § 1.167(a)-3 should be interpreted as providing that "goodwill" is nondepreciable *because* it does not have a reasonably ascertainable useful life. *See, e.g., Richard S. Miller & Sons, Inc. v. United States*, 537 F.2d 446, 451 (Ct. Cl. 1976) ("Since by definition goodwill has no ascertainable useful life, the presumption that this intangible is a nondepreciable capital asset is conclusive."); *Colorado National Bankshares, Inc. v. Commissioner*, 60 T.C.M. 771, 789 (1990) ("Goodwill, by definition, has an indefinite life . . . ."); H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 936-37 (1987) ("because goodwill does not have a determinable useful life, no depreciation deduction is allowed with respect to that intangible asset.").

Read in this way, the sentence in Treas. Reg. § 1.167(a)-3 concerning "goodwill" would not apply to any asset with a reasonably ascertainable useful life, and therefore such an asset would be depreciable. This is consistent with both the statutory mandate of a depreciation allowance for wasting assets and the general scheme of the section 167(a) regulations that allows depreciation for all assets with limited useful lives. It is also consistent with the purpose of section 167(a), which is to match income with the expenses incurred to produce the income.

D. The Errors of the Third Circuit's Approach.

The Third Circuit chose to virtually ignore the first sentence of Treas. Reg. § 1.167(a)-3 and to look outside of the four corners of the regulation to interpret the

term "goodwill". It engaged in the purely semantic exercise of determining how "goodwill" has been used by various courts. It did so even while admitting that "goodwill" is an "elusive concept" and that there is no "uniform or coherent definition of the term." Pet. App. at 10a n.5. Without adopting any rigorous definition of "goodwill", it determined that the initial paid subscribers were inextricably entwined with "goodwill" and therefore were not depreciable. Yet it left undisturbed the district court's factual finding that they have limited useful lives that can be determined with reasonable accuracy, *i.e.*, that they are wasting assets.

In effect, the Third Circuit read the provision in Treas. Reg. § 1.167(a)-3 concerning "goodwill" as an *exception* to the basic rule that wasting assets are depreciable, instead of as an *example* of the corollary rule that assets without a reasonably ascertainable life are not depreciable. This interpretation of the regulation's reference to "goodwill" violates the rules for regulatory construction set forth above. It conflicts with the mandate of the statute and the regulatory scheme under section 167(a) that wasting assets, whether tangible or intangible, be depreciated. *Northern Natural Gas*, 277 F.2d at 131-132. Moreover, the Third Circuit's approach conflicts with the purpose of the depreciation allowance, which is to match income with the expenses incurred to generate the income. *Massey Motors*, 364 U.S. at 104.

Furthermore, the Third Circuit's interpretation of "goodwill", as that term appears in Treas. Reg. § 1.167(a)-3, treats intangible assets with reasonably ascertainable useful lives differently from tangible assets with reasonably ascertainable useful lives, and therefore is inconsistent with the statute and the section 167(a) regulations. As the Third Circuit admitted in its opinion,

> we believe that the Service is correct in asserting that, for tax purposes, there are some intangible assets which, notwithstanding that they have wasting lives that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and nondepreciable. [Pet. App. at 28a-29a.]

This would be an extraordinary statement if applied to tangible assets. It is equally extraordinary when applied to intangible assets, because the statute does not distinguish between tangible and intangible assets and the regulations applying to intangible assets are essentially the same as those applying to tangible assets.

The inconsistency created by the Third Circuit's opinion can be seen by comparing two situations, one involving tangible assets and one involving intangible assets. Suppose the following facts: Taxpayer A purchases a delivery service that has one hundred delivery trucks at the time of purchase. The delivery trucks have an average useful life of eight years. (In this particular case, the useful life would be determined under section 168, rather than by a facts and circumstances analysis. This is not relevant for purposes of this analogy.) Ten years later, Taxpayer A is still operating the delivery service and still has one hundred delivery trucks. Assume that by that time, all of the trucks acquired as part of the original purchase have been retired and replaced. The tax law allows Taxpayer A to recover the cost of the initial one hundred trucks over their eight-year useful life, even though Taxpayer A still has one hundred trucks at the end of ten years.

Now suppose Taxpayer B purchases a newspaper that has one hundred subscribers at the time of purchase. The initial subscribers can be expected to remain subscribers for an average of eight years. Ten years later, Taxpayer B is still operating the newspaper and still has one hundred subscribers. Assume that by that time, all of the subscribers acquired as part of the original purchase have left the newspaper and have been replaced.

Under the Third Circuit's approach, the portion of the purchase price paid by Taxpayer B that is allocable to the initial one hundred subscribers would not be recov-

ered for tax purposes over their eight-year useful life. Taxpayer B, which is in exactly the same economic situation as Taxpayer A, bears a heavier tax burden than Taxpayer A under the Third Circuit's approach merely because Taxpayer B bought a business with a significant intangible asset.

It is not relevant that in the case of Taxpayer A the costs of replacement trucks will be capitalized and then depreciated, while in the case of Taxpayer B the costs of replacing subscribers will be deducted. First, Treas. Reg. § 1.167(a)-3 does not tie the depreciation deduction to the tax treatment of replacement costs, either implicitly or explicitly. It simply requires that the asset be useful in the business for only a limited period, the length of which can be estimated with reasonable accuracy.

Second, Taxpayer A will not necessarily capitalize all of the costs of replacing the trucks. Under section 179, Taxpayer A may be permitted to deduct up to $10,000 of the cost of new replacement trucks each year. Yet NAA is not aware that the Commissioner of Internal Revenue (the "Commissioner") has ever argued that a deduction for replacement costs means that the cost of the initial one hundred trucks is not depreciable. Similarly, the fact that section 173 allows a taxpayer to deduct replacement costs for subscribers [6] has no bearing on whether the cost of the initial one hundred subscribers is depreciable.

Accordingly, the Third Circuit's approach treating tangible and intangible assets differently flies in the face of the statute, the regulations, and sound economic and tax policy.

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[6] Section 173 provides in part that

> all expenditures (other than expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical) to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical shall be allowed as a deduction . . . .

E. Summary.

Under a proper interpretation of Treas. Reg. § 1.167(a)-3, the initial paid subscribers fall within the first sentence of the regulation and cannot be "goodwill" because they have reasonably determinable useful lives. If the regulation were to be interpreted as the Third Circuit urges, its simple sentence about "goodwill" would become, as applied to the facts of this case, a singular exception to the basic rule of the statute mandating a depreciation allowance for a wasting asset. If an exception had been intended, one would have expected the regulation to state so explicitly. Furthermore, in the absence of any statutory or regulatory hint that the sentence concerning "goodwill" is an exception to the basic rule, a construction that interprets that sentence as an exception should be avoided because it would be totally inconsistent with the statute and the section 167(a) regulations.[7]

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[7] NAA believes that the Commissioner's interpretation of Treas. Reg. § 1.167(a)-3 would render the regulation invalid. Such an interpretation would prevent the depreciation of an asset having a reasonably ascertainable useful life, and would therefore restrict the allowance for depreciation mandated by Congress. *See, e.g., Niagara Falls Brewing Co. v. Commissioner*, 38 F.2d 217, 220 (2d Cir. 1929), *aff'd*, 282 U.S. 648 (1931) (Treasury regulation regarding depreciation "created an additional burden upon the taxpayer, not provided for by the statute, and is unlawful."); *Estate of Boeshore v. Commissioner*, 78 T.C. 523, 527 (1982) (Treasury regulation "may not usurp the authority of Congress by adding restrictions to a statute which are not there."). This Court should avoid a construction of Treas. Reg. § 1.167(a)-3 "which raises doubt as to the validity of the regulation." *Northern Natural Gas*, 277 F.2d at 134; *see also Southland Royalty Co. v. Federal Energy Admin.*, 512 F. Supp. 436, 446 (N.D. Tex. 1980) ("If an agency is powerless to create regulations which conflict with Congressional intent, then it follows that an agency is equally powerless to interpret an existing regulation in such a way as to cause consequences inconsistent with the purpose of the enabling act, and that such an interpretation is a nullity.") (citing *Federal Maritime Comm. v. Seatrain Line*, 411 U.S. 726 (1973)); *Bhada v. Commissioner*, 89 T.C. 959, 972-73

Although this case involves the interpretation of Treasury Department regulations by the Commissioner, a court "must reject an administrative interpretation when there are compelling indications that it is wrong." *Collums v. United States*, 480 F. Supp. 864, 869 (D. Wyo. 1979) (citing *Espinoza v. Farah Mfg. Co.*, 414 U.S. 86, 94-95 (1973) and other cases); *see also Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969); *United Fire Insurance Co. v. Commissioner*, 768 F.2d 164, 169 (7th Cir. 1985).[8] The Commissioner's interpretation of Treas. Reg.

(1987), *aff'd*, 892 F.2d 39 (6th Cir. 1989) (interpreting Treasury regulation to avoid construction that would bring into question the validity of the regulation).

[8] This is not a case in which the Commissioner is entitled to heightened deference by virtue of the "legislative reenactment" doctrine. The legislative reenactment doctrine does not apply here for a number of reasons. First, although Treas. Reg. § 1.167(a)-3 may be long-standing, the Commissioner's current interpretation of the regulation is not. The Commissioner's interpretation of Treas. Reg. § 1.167(a)-3 (that a wasting intangible asset may constitute non-depreciable "goodwill" even though it has a limited useful life and an ascertainable value) is a relatively recent position. Where an interpretation of a regulation has been neither "uniform" nor "long-standing," the legislative reenactment doctrine does not apply. *See, e.g., Iselin v. United States*, 270 U.S. 245, 251 (1926). By contrast, prior to this case, authority existed for the position that an intangible asset with a limited useful life could *not* constitute non-depreciable "goodwill". *See, e.g., Richard S. Miller & Sons*, 537 F.2d at 454 ("[a]n intangible asset is separate and distinct from goodwill when its useful life can be shown with reasonable accuracy to be of limited duration."); *Colorado National Bankshares*, 60 T.C.M. at 789 (rejecting Commissioner's interpretative position that even if taxpayer "has established a 'life' and a 'value' for core deposits intangible, we must still inquire whether it is, in essence, goodwill"). Second, the legislative reenactment doctrine does not apply here because there is no indication that Congress has ever focused on the Commissioner's interpretation. *See United States v. Calamaro*, 354 U.S. 351, 359 (1957) (where reenactment of tax legislation was not accompanied by any discussion of regulation at issue, reenactment was "without significance"). Finally, because the Commissioner's interpretation of Treas. Reg. § 1.167(a)-3 is erroneous, the legislative reenactment doctrine is inapplicable. *See,*

§ 1.167(a)-3 (which was adopted by the Third Circuit) is inconsistent with the statutory mandate of section 167(a), the Treasury's own regulatory scheme under the section 167(a) regulations, and the purpose of the statute and regulations. Accordingly, there are "compelling indications" that the Commissioner's interpretation of Treas. Reg. § 1.167(a)-3 is wrong and should be rejected.

II. THE INITIAL PAID SUBSCRIBERS ARE ANALOGOUS TO PATENTS AND SHOULD BE TAXED SIMILARLY.

An additional indication that the Commissioner's interpretation of Treas. Reg. § 1.167(a)-3 is wrong can be found within the four corners of Treas. Reg. § 1.167(a)-3 itself. Treas. Reg. § 1.167(a)-3 provides that "goodwill" is not depreciable. Although what constitutes "goodwill" within the meaning of Treas. Reg. § 1.167(a)-3 has been the source of enormous confusion and uncertainty, the regulation itself provides guidance concerning the proper interpretation of the term. Specifically, it provides that a patent may be depreciated. The economic and tax characteristics of a patent are straighforward. If another asset shares those same economic and tax characteristics, that is a strong indication that under the policy of Treas. Reg. § 1.167(a)-3, the other asset should also be depreciable. Put another way, because a patent is not included in "goodwill", Treas. Reg. § 1.167(a)-3 should be interpreted so that any asset that shares a patent's characteristics is likewise not included in "goodwill".

The initial paid subscribers are in all material ways directly analogous to patents. First, the price that a purchaser is willing to pay for a patent is invariably based upon the future income that the patent is expected to gen-

e.g., Clifford v. Helvering, 105 F.2d 586, 591 (8th Cir. 1939), *rev'd on other grounds*, 309 U.S. 331 (1940) (rejecting a "plainly erroneous" construction despite legislative reenactment). *See generally* 1 *Mertens Law of Federal Income Taxation* §§ 3.89 to 3.97 (1992).

erate. The future income ordinarily depends on the expected future sales of products that are manufactured using the patent; those sales need not be generated under any pre-existing contracts. In short, the price that a purchaser is willing to pay for a patent depends on the expectation of future patronage. Similarly, the portion of the purchase price of a newspaper that is attributable to the paid subscribers is based upon the expectation of future patronage.

Second, a patent has a limited useful life in the business. The term of a patent generally extends for a period of 17 years, or up to 14 years in the case of a design patent. 35 U.S.C. §§ 154, 173. The statutory life of the patent establishes a maximum useful life, but taxpayers are allowed to prove a shorter useful life. Treas. Reg. §§ 1-167(a)-1(b), 1-167(a)-3, and 1.167(a)-6(a).[9] Similarly, the initial paid subscribers have limited use-

[9] Treas. Reg. § 1.167(a)-6(a) specifies that a patent is to be depreciated over its remaining useful life. Treas. Reg. § 1.167(a)-3 also states that if an intangible asset is known from experience or other factors to be of use in the taxpayer's trade or business for only a limited period, and that length of time can be estimated with reasonable accuracy, then the intangible asset may be the subject of a depreciation allowance. Patents are specifically mentioned in the regulation. Treas. Reg. § 1.167(a)-1(b) further states that the useful life of an asset is not necessarily the useful life inherent in the asset (in the case of patents, generally 17 years), but rather may be the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business. Accordingly, a taxpayer is entitled to prove that a patent has a shorter useful life than the the remaining legal life of the patent. *See Associated Patentees, Inc. v. Commissioner*, 4 T.C. 979, 986 (1945), *acq.*, 1959-2 C.B. 3 (adopting depreciation method with respect to patent in which taxpayer is entitled to depreciation deduction only in years that patent earns income; rejecting Commissioner's contention that each payment must be capitalized and then prorated over the remaining legal life of the patent); Rev. Rul. 67-136, 1967-1 C.B. 58 (agreeing to follow *Associated Patentees* decision); *see also* Petry, M., *Taxation of Intellectual Property* ¶ 3.18, at 3-64 to 3-67 (1991); Cross, J., 209-4th Tax Management Portfolios, *Purchase Price Allocation and Amortization of Intangibles* A-35 (1991).

ful lives in the business, as the Third Circuit itself admitted. Pet. App. at 29a.

Third, the costs of creating a patent through one's own efforts are generally deductible under section 174(a). That Code provision allows a taxpayer to deduct "research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business . . . ." Such expenditures incurred in creating a patent qualify for the current deduction under section 174(a). Alternatively, in lieu of claiming a current deduction under section 174(a), a taxpayer may elect generally to treat such expenditures as deferred expenses which are deductible ratably over a period of not less than 60 months. Section 174(b). Similarly, section 173 allows a taxpayer to deduct the costs of establishing, maintaining, or increasing the circulation of a newspaper. Alternatively, in lieu of taking a current deduction for circulation expenditures under section 173, a taxpayer may elect to capitalize that portion of the circulation expenditures which is properly chargeable to capital account. Section 173(a); Treas. Reg. § 1.173-1(c)(1). Moreover, for purposes of computing a taxpayer's alternative minimum tax, the deductions under sections 173 and 174 are often treated in a similar manner (and in some cases within the same subparagraph of a Code section).[10]

Fourth, the costs of purchasing a patent from a third party are not deductible, but instead must be capitalized. *See* Treas. Reg. § 1.174-2(a)(1) (providing in part that "research or experimental expenses" do not include "the costs of acquiring another's patent"). Similarly, section 173 does not allow a current deduction for the purchase

[10] *See* section 56(b)(2) (requiring individuals to capitalize for alternative minimum tax purposes amounts allowable as a deduction under sections 173 and 174(a)); section 59(e) (election to capitalize amounts allowable as a deduction under sections 173 and 174(a) for regular tax purposes and avoid alternative minimum tax adjustment).

of newspaper subscribers. *See* Rev. Rul. 74-103, 1974-1 C.B. 62; Treas. Reg. § 1.173-1(a)(1).

Fifth, when the creator of a patent sells all substantial rights to it, the creator is generally eligible for capital gain treatment under either section 1221, 1231, or 1235. When the owner of a newspaper sells it, the gain attributable to the paid subscribers is generally treated as capital gain under either section 1221 or 1231.

The above analysis shows that patents and the initial paid subscribers have essentially identical tax and economic characterizations. Accordingly, they should be treated the same for purposes of Treas. Reg. § 1.167(a)-3. Because the cost of acquiring a patent from a third party is depreciable over the useful life of the patent (*see Newton Insert Co. v. Commissioner*, 61 T.C. 570, 586 (1974), *aff'd per curiam*, 545 F.2d 1259 (9th Cir. 1976); Treas. Reg. § 1.167(a)-6(a)), so should the cost of acquiring the initial paid subscribers from a third party be depreciable over the useful lives of such subscribers.

III. NEWSPAPER SUBSCRIBERS CANNOT BE ANALYZED SIMPLY AS CUSTOMERS.

The foregoing portions of this brief conclude that for purposes of Treas. Reg. § 1.167(a)-3, the initial paid subscribers should be treated as a depreciable intangible asset pursuant to the first sentence of the regulation and "goodwill" should be interpreted to include only assets with indeterminate useful lives. Under that interpretation, the initial paid subscribers would not constitute nondepreciable "goodwill". NAA believes that no further analysis is required.

But even if this interpretation is rejected and "goodwill" is interpreted more broadly to refer to customers in some way, the initial paid subscribers would still not constitute "goodwill". This is because their primary value to a newspaper comes not from their status as customers

of the newspaper, but from the newspaper's ability to use the subscribers to attract advertising.

The Third Circuit analyzed the depreciability of the paid subscribers as if the value of the initial paid subscribers arose only from their status as customers of the newspapers. It stated:

> *Customer* lists are generally not amortizable when acquired in conjunction with a sale of the underlying business as a going concern. In the context of the sale of a going concern, it is simply often too difficult for the taxpayer and the court to separate the value of the list *qua* list from the goodwill value of the *customer* relationship/structure. [Pet. App. at 29a; emphasis added.]

This paragraph shows that the Third Circuit approached the initial paid subscribers only as customers of the newspapers. Because it did so, it concluded that the value of the subscribers was inextricably linked with "goodwill" and therefore nondepreciable.

Treating the subscribers to a newspaper as only customers, and as no other source of value, misapprehends the nature of newspaper subscribers. In a typical daily newspaper, perhaps 70 percent to 80 percent of the revenue comes from advertisers. For the newspapers at issue in this particular case, approximately 80 percent of their total revenue came from sales of advertising. Pet. App. at 38a; *see also Donrey, Inc. v. United States*, 809 F.2d 534, 535-36 (8th Cir. 1987) (evidence indicated that 80 percent of newspaper's total revenues came from advertising). Advertisers use a newspaper because it enables them to reach the readers of the newspaper. In a real sense, the initial paid subscribers are not only customers of the newspaper, but even more importantly are customers (or intended customers) of the newspaper's advertisers, who are willing to pay significant sums to the newspaper to obtain access to the subscribers. Accordingly, it is incorrect to analyze the paid subscribers only

as "customers" of the newspaper. They are a tool that the newspaper uses to attract most of its revenues from its real customers.

Because newspaper subscribers are more than "customers", the value of the initial paid subscribers is not properly attributable to what the Third Circuit meant by "goodwill".

NAA acknowledges that the particular valuation method primarily used by Petitioner's experts valued the initial paid subscribers according to the incremental subscription revenues that they generate. However, it is possible to value the initial paid subscribers using other income methods that are not keyed solely to subscription revenues. These alternative approaches instead value the subscribers as a function of the advertising revenues that they generate. Petitioner's own expert used such a method as an alternative in this case (see Pet. App. at 46a), and other NAA members have used similar methods. Thus, the particular income valuation approach chosen by this particular taxpayer does not negate the fact that the initial paid subscribers are more than mere "customers" of the newspaper.

CONCLUSION

The interpretation of Treas. Reg. § 1.167(a)-3 adopted by the Third Circuit conflicts with the statutory mandate of a depreciation allowance for wasting assets, the regulatory scheme under section 167(a), and the words of Treas. Reg. § 1.167(a)-3 itself. NAA urges this Court to interpret Treas. Reg. § 1.167(a)-3 in a way that is consistent with the statutory mandate and the Treasury's own regulations.

Respectfully submitted,

GEORGE L. MIDDLETON, JR.
Counsel of Record
CHRISTIAN M. MCBURNEY
CORRINE M. YU
NIXON, HARGRAVE, DEVANS & DOYLE
One Thomas Circle, N.W.
Suite 800
Washington, D.C. 20005
(202) 457-5300
Counsel for Newspaper Association of America

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